

# The Effect of IFRS Adoption on Supply Chain Management and Earnings Persistence

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**Abstract.** This study aims to examine the effect of the International Financial Reporting Standards (IFRS) adoption on supply chain management and earnings persistence. This research is quantitative research with multiple linear regression models. The sample used in this research is manufacturing companies listed on the Indonesia Stock Exchange (IDX). The type of data used in this study is secondary data in the form of financial statements and annual companies listed on the Stock Exchange from 2009 to 2015. The sample selection using a purposive sampling method with the number of samples of 66 companies, so that the overall sample amounted to 462 observations. This study uses data with the same number of years for three years, so that this paper is research with panel data. The results that IFRS had significant association with supply chain management. A better implementation of international financial reporting, as a set of principle-based standards is the key to enhance the supply chain management for earning managements.

**Keywords—** Supply Chain Management, IFRS Adoption, Earnings Persistence

## 1. Introduction

In recent decade, supply chain analysis, growth and development has grown rapidly. Supply chain management is a quickly developing sector which has considerable impact on profit and business management experts. One of the main focuses of financial statements for recognizing financial performance is information about earnings and its components [1]. Private parties often use earnings as a basis for decision-making, such as compensation and bonus sharing to managers, performance meters, or management performance. Therefore, the quality of earnings becomes the center of attention for investors, creditors, accounting, and government policymakers. High-quality earnings can be assessed using earnings persistence [2] because it can reflect future sustainability [3]. Earnings persistence shows the ability of a company to be able to maintain earnings over time and describes the company does not perform an action that can mislead information

users, where the company's earnings are not fluctuating sharply. Earnings persistence is examined by using the regression result between current earnings performance and future earnings performance [4]. Earnings persistence can be used by investors to evaluate the company's performance based on the company's earnings obtained in the current year. This predictive value element of earnings persistence can be used by stakeholders to evaluate past, present, and future events [5].

The earnings persistence can also be determined by the accruals and cash flow components contained in current earnings [6]. Naive investors fixate on earnings and can not consider the existence of the accrual component of the earnings so as not to suspect the poor performance generated in the future period due to low accrual persistence [7]. The importance of accruals persistence to be examined because it can minimize the occurrence of wrong pricing of securities (Sloan, 1996). Accruals are also more relevant than cash flow to reflect company performance [8].

Accurate disclosure and presentation of earnings information require an accounting standard. IFRS (International Financial Reporting Standards) answers the challenge of how financial reporting should be done. IFRS is a set of high-quality global accounting standards that can be adopted by all countries around the world [9]. IFRS adoption is one of the Indonesian government's agreements as a member of the G20 forum. Indonesia gradually converged to full adoption of IFRS. Financial Accounting Standards (FSA) that have adopted all IFRS first applied in 2012 [10]. The benefits of IFRS adoption have become a critical debated phenomenon in many countries. Research that focuses on the influence of IFRS adoption on earnings persistence shows different results. In the study of [11] also find that earnings become less persistent after Brazil adopted IFRS as a financial accounting standard. While [12], who research the context of emerging market countries, find that the level of IFRS adoption also does not affect the persistence of earnings in the future. Using high-

quality accounting standards, accounting information reported in the financial statements becomes informative and reliable, improving the quality of earnings is more persistent or stable [13]. IFRS, as a higher and tighter accounting standard with at least a choice of accounting methods provided, will limit managerial policies [14]. The accrual basis allows for the behavior of managers to increase or decrease the accrual rate in the income statement. However, this is not the result of research by [15]. They using sample firms in Brazil, shows that the reliability of the accruals component as a determinant of earnings in the future period declines after Brazil adopts IFRS.

The differences in IFRS adoption rates in each country are not able to make research in other countries as a benchmark of the influence of IFRS adoption on earnings persistence and accruals persistence, which is a reflection of accounting quality. By the above description, empirically, it is necessary to prove the influence of IFRS adoption on earnings persistence and accruals persistence in Indonesia. Moreover, Indonesia is a relatively new country in implementing IFRS when compared with countries in Europe that have adopted full IFRS starting in 2005 [16]. Thus, it is necessary to develop and compare research into whether the adoption of IFRS can improve the quality of earnings more persistent or stable.

Based on the above description, this study aims to examine the effect of IFRS adoption on earnings persistence and supply chain. This study differs from previous studies. Earnings persistence measured by the regression model of pretax accounting earnings because this study uses IFRS that examines its influence on earnings persistence. In this study, Measurements of IFRS variables in this study differ from [17] using scores according to the adoption rate of each of the countries studied. This study only examines the adoption of IFRS in Indonesia so that it can use dummy variables that are adjusted to the year of IFRS implementation in Indonesia.

The signals of prosperity in the form of earnings that grow and stable can be influenced by supply chain policy undertaken by the company. Based on the above description, the first hypothesis in this study are:

H1: Supply Chain is associated with earnings persistence

Signaling theory explains why companies need to provide financial statements to external parties

because there is information asymmetry between firms and outsiders. The quality of information will be increased if the company does supply chain. A set of methods used for the effective and efficient integration of suppliers, manufacturers, warehouses and sellers in such a way that in order to minimize system costs and meet the needs of services, goods in the right number in the right place and at the right time to produce and distribute. Supply Chain Management Coordinates the production, inventory, location, and transportation between participants in a supply chain to achieve the best combination of accountability and efficiency for market success.

In [18] prove that non existence of SCM can weaken accruals persistence. With this objective, the company will suspend its revenue and accelerate the recognition of expenses. Based on the description, the second hypothesis in this study are:

Based on signaling theory and previous research, IFRS adoption in Indonesia will also affect earnings persistence, which is one of the accounting quality perspective [19]. When a country adopts IFRS, it has a higher and more stringent accounting standard that chooses accounting methods given less. Higher and more stringent accounting standards make accounting information reported in the financial statements informative and more accountable to improve the quality of earnings or make earnings more persistent or stable. Based on the above description, then the hypothesis proposed as follows:

H3: IFRS adoption is associated with supply chain

The accounting figures reported by the company can be used as a signal if they can reflect information about the attributes of corporate decisions that cannot be observed. Investors in the capital market need Complete, relevant, accurate, and timely information as an analytical tool to make investment decisions, which is provided in supply chain system. IFRS, as an accounting standard, governs how qualitative characters of financial statements must be met so that financial statements can be qualified and useful for its users. IFRS, as a more stringent accounting standard, will reduce the management level to make earnings management. IFRS adoption in EU countries affects at least income smoothing, at least discretionary accruals, and increased accrual quality [20]. At least discretionary accruals will increase the ability of accruals to determine

earnings in the future. While the adoption of IFRS in Brazil weakened the relationship between the current period's earnings accruals with future accounting earnings. Based on the signaling theory and previous research, IFRS adoption in Indonesia will also affect accruals persistence. IFRS, as a tighter accounting standard, will reduce the level of management to the discretion on the accruals process.

## 2. Methods

The type of research used in this study is a quantitative method with the causal that describes the cause of one or several problems. Research conducted by way of data processing and analysis to get a conclusion on existing data. The analysis in this research is conducted using multiple linear regression models. This study uses secondary data which are financial statements of a manufacturing company listed in Indonesia Stock Exchange (ISE) from 2008 to 2016. There is a variable using data from the previous year so that the year is begun in 2008, while there is a variable using data from the following year, so the year was ended in 2016. Thus, the core data using in this study, starting from 2009 up to 2015.

Earnings Persistence and accruals persistence are unique to each of the different industry characteristics [21]. Therefore, this study only examines one industry that is the manufacturing industry. Manufacturing companies are selected because they have the same characteristics so that the impact of the independent variables can be more observed. Also, the manufacturing sector has a cycle of production and sales of goods not owned by other sectors. The sample use of financial institution companies gives different results because their income is influenced by government regulation. This study uses the type of panel data because the sample data used is a combination of companies within more than one year. Financial statement data of companies listed on the Stock Exchange can be obtained by downloading from the official website of IDX at <http://www.idx.co.id>. Sample selection is conducted by purposive sampling. Therefore, unqualified population members will not be selected as research samples. The sample selection is conducted by eliminating the population from having the criteria. Firstly, companies that IPO are conducted after 01 January 2008. Secondly, companies that do not have complete data from 2008 to 2016. Finally,

companies use USD currency in their financial statements.

$$BTDit = \alpha_0 + \alpha_1 \Delta INVit + \alpha_2 \Delta REVit + \alpha_3 NOLit + \alpha_4 TLUit + \epsilon it$$

Where:

BTDit = BTD reported by company i in year t

$\Delta INVit$  = change in investment in gross tangible fixed assets and intangible fixed assets from year t-1 to year t

$\Delta REVit$  = change in income from year t-1 to year t

NOLit = total net operating loss of company i in year t

TLUit = total losses that have been compensated for the company i in year t

To control the size of the firm, all of the above variables are scaled to total assets in year t.

The use of IFRS variables as moderators refers to the research of Martinez et al. (2016). IFRS is used in the statistical model for testing H2 and H3. IFRS variable is dummy variable IFRS is equal to 0 for reporting period until 2012, and IFRS is equal to 1 for another reporting period.

Hypothesis testing in this study using two models. The first model as the basis of earnings persistence estimation as applied in Hanlon's research (2005):

$$PTBI_{it+1} = \beta_0 + \beta_1 PTBI_{it} + \epsilon it$$

Where:

$PTBI_{it+1}$  = pre-tax book income i in year t + 1;

$PTBI_{it}$  = pre-tax book income i in year t.

Model 1

$$PTBI_{it+1} = \beta_0 + \beta_1 PTBI_{it} + \beta_2 ABS \ ABTDit + \beta_3 PTBI_{it} \times ABS \ ABTDit + \beta_4 IFRSit + \beta_5 PTBI_{it} \times IFRSit + \epsilon it$$

If the regression coefficient of pre-tax book income ( $\beta_1$ ) is not positive so that the earnings persistence is not fulfilled, then the test of Model 1 can not be implemented.

The second model is the basis of the accruals persistence estimation. Hanlon (2005) divides pre-tax book income into two components, namely pre-tax accruals and pre-tax cash flows. The following is the basic model of estimation:

$$PTBI_{it+1} = \beta_0 + \beta_1 PTCFOit + \beta_2 PTACCit + \epsilon it + 1$$

In which:

$PTBI_{it+1}$  = pre-tax book income i in year t + 1;

PTCFOit = pre-tax cash flows i in year t;

PTACCit = pre-tax accruals i in year t.

Accruals persistence will be fulfilled if the pre-tax accruals regression coefficient ( $\beta_2$ ) is positive. That is, the accrual components of earnings in the current period have a positive effect on pre-tax book income in the future period. The second

model is developed by including the tax avoidance moderation variable (ABS ABTD) and IFRS. This second equation model is used to test H2 and H4. The following is the estimation equation:

Model 2

$$PTBI_{it+1} = \beta_0 + \beta_1 PTCFO_{it} + \beta_2 PTACC_{it} + \beta_3 ABS\_ABTD_{it} + \beta_4 PTCFO_{it} \times ABS\_ABTD_{it} + \beta_5 PTACC_{it} \times ABS\_ABTD_{it} + \beta_6 IFRS_{it} + \beta_7 PTCFO_{it} \times IFRS_{it} + \beta_8 PTACC_{it} \times IFRS_{it} + \epsilon_{it+1}$$

If the accrual component of the earnings regression coefficient ( $\beta_2$ ) is not positive so that the accruals persistence is not fulfilled, then the test of Model 2 cannot be implemented.

### 3. Result And Discussion

The selection of research samples by using purposive sampling is presented in Table 1 as follows.

Table 1 Samples Selection

No	Criteria	Total	Measurements
1	Manufacturing companies listed on the BEI	144	Firms
2	Companies listed on BEI are registered from 2014 to 2016	(27)	Firms
3	Companies whose financial statements use the USD currency	(28)	Firms
4	Companies with variable data are incomplete	(28)	Firms
Total Companies		66	Firms
Total Firm-Year from 2008 to 2016)		594	Firm-Year
Total Sample (from 2009 to 2015)		462	Firm-Year

Source: Processed

Under purposive sampling, 66 companies are taken as a sample in this research. The total firm-years studied is 594. However, measurement of earnings persistence and accruals persistence requires a period of data  $t + 1$ , i.e., the pre-tax book income  $t + 1$  and for the measurement of tax avoidance requires period  $t-1$  data, i.e., fixed assets data and

intangible assets  $t-1$  period, so that the focus of the research year to seven years from 2009 to 2015. The research sample focus is 462 firm-year.

The descriptive statistical analysis in this study is described by using the mean, maximum, minimum (minimum), and standard deviation (std. dev.). The summary of the results of descriptive statistics on the variables data in this study as follows:

Table 2 Descriptive Statistics

	Mean	Med.	Max.	Mini.	Std. Dev
PTBI <sub>t+1</sub>	0.1248	0.0865	1.3688	-0.278	0.1629
PTBI <sub>t</sub>	0.1152	0.0839	0.8848	-0.261	0.1402
PTACC <sub>t</sub>	-0.047	-0.0189	0.4254	-1.464	0.2091
PTCFO <sub>t</sub>	0.1624	0.0992	1.9792	-0.378	0.2818
ABS ABTD	0.0228	0.0126	0.5134	0.00002	0.0405
IFRS	0.5714	1	1	0	0.4954

The results of a series of regression model selection tests (chow test, Lagrange multiplier test, Hausman test) show that the most appropriate regression model in this research is the random

effect model in model 1 and fixed-effect model in model 2. The hypothesis testing summary, as follows:

Table 3 The hypothesis testing summary Model 1

Variable	Coeff	t-Stat	Prob.	Hypothesis
C	0.0224	2.7627	0.0030	***
PTBI <sub>it</sub>	1.0527	24.357	0.0000	***
ABS_ABTD	-0.2949	-1.5992	0.0553	*
PTBI <sub>it</sub> * ABS_ABTD	-0.1094	-0.2320	0.4083	Rejected
IFRS	-0.0164	-1.7926	0.0369	**
PTBI <sub>it</sub> * IFRS	-0.0395	-0.7766	0.2189	Rejected
R <sup>2</sup>	0.7656			
Adj. R <sup>2</sup>	0.7630			
F-stat.	297.89			
Prob(F-stat.)	0.0000			

Table 4 The hypothesis testing summary Model 2

Variable	Coeff.	t-Stat	Prob.		Hypothesis
C	0.0676	10.454	0.0000	***	Fulfilled
PTACC <sub>it</sub>	0.5719	11.192	0.0000	***	
PTCFO <sub>it</sub>	0.6007	12.841	0.0000	***	
ABS_ABTD	-0.0671	-0.5331	0.2972		Accepted
PTACC <sub>it</sub> * ABS_ABTD	-1.2836	-2.7166	0.0035	***	
PTCFO <sub>it</sub> * ABS_ABTD	0.1304	0.4592	0.3232		
IFRS	-0.0149	-4.0155	0.0001	***	Accepted
PTACC <sub>it</sub> * IFRS	-0.0778	-2.0259	0.0217	**	
PTCFO <sub>it</sub> * IFRS	-0.0767	-2.6839	0.0038	**	
R <sup>2</sup>	0.9482				
Adj. R <sup>2</sup>	0.9385				
F-stat.	97.418				
Prob(F-stat.)	0.0000				

### Discussion of the effect of SCM on earnings persistence

The results suggest that SCM is associated with earnings persistence, meaning the level of SCM make more or fewer earnings persistence. The results of this study are consistent with the results of the research of [22], which examines the effect of SCM on changes in pre-tax earnings. The samples used by [22] are companies engaged in the tourism and hospitality services sector and banking sector that is consistently listed on the Indonesia Stock Exchange (IDX) period 2010 to 2014. This study shows SCM that affect earnings persistence. SCM conducted by a company does not make current period earnings more or less reliable in determining future earnings period. Go public companies generally tend to high profile than companies are not going public. For stock market prices to rise, the company's managers will try to look their best by keeping their earnings persistence. The company's ability to generate high earnings is a benchmark for investors in assessing the profitability of the company.

Statistically, the earnings persistence of the sample of manufacturing companies in Indonesia is considered reliable because the regression coefficient is worth 1. The company is maintaining the earnings persistence to be valued both by investors and auditors for the sustainability of the company in the future. Earnings persistence is a measure of the quality of earnings used by investors to assess firm performance. Like any company's strategy, for example, tax avoidance, the company will remain consistent in keeping its earnings persistence.

### Discussion of the effect of IFRS adoption on earnings persistence

The results suggest that the adoption of IFRS is not associated with earnings persistence. It means earnings persistence still stagnant even though Indonesia has adopted IFRS into Indonesia Financial Accounting Standards. The results of this study are consistent with the results of [23] using observations of 4,305 public companies listed on the Stock Exchange of 11 countries included in emerging market countries, found that the adoption rate of IFRS has no effect on earnings persistence in the future. This study shows different results with research by [24], who observe the influence of IFRS adoption on earnings persistence in 727 non-financial companies in Brazil. Based on his research, it was found that the adoption of IFRS had a negative effect on earnings persistence. This difference in outcomes can be due to differences in adoption rates by individual countries such as effective date differences, differences in transitional provisions, and textual differences [25]. Prastika et al. (2014) testing whether there is a significant difference between earnings persistence before and after IFRS at 30 manufacturing companies listed on the Indonesia Stock Exchange from 2010 to 2013, showing different results with this study. There is a significant difference between the earnings persistence before and after IFRS adoption in [4]. In [17] Also, in purposive sampling, [8] issued a company with negative earnings from the sample. Companies with negative earnings or losses are, indeed, the quality of financial reporting is in doubt. This means the company is not able to maintain earnings persistence. Financial reporting is said to be of high

quality if current earnings can be a good indicator of future corporate earnings.

This study shows that IFRS adoption has no impact on corporate earnings being more persistent or not. It has been previously described that earnings persistence has a predictive value that reflects relevance in the qualitative nature of accounting information. Before the adoption of IFRS, the characteristics of relevance have been part of the qualitative characteristics of accounting information. Earnings persistence is a prediction approach in understanding the relevance of the value of accounting information. Earnings become relevant for accounting information when it is useful to predict future company performance prospects. Before IFRS is adopted into Indonesia Financial Accounting Standards, earnings persistence is of particular concern to both companies and investors.

Discussion of the influence of IFRS adoption on the supply chain

The result suggests that IFRS adoption is directly associated with supply chain system. The results of this study are consistent with the research of [13] This study proves that the adoption of IFRS has decreased the ability of accruals to determine future earnings. The purpose of IFRS convergence is one of them to improve the quality of financial statements seems to have not succeeded. It is because there is still a gap for managers to do accrual discretion. In [19] employed sample manufacturing companies in Indonesia, stated that the convergence of IFRS is not able to suppress the practice of accrual earnings management.

Supply chain management is performed at the end of the reporting period through the selection of accounting policies performed by management. IFRS as a set of principle-based standards that enable managerial discretion. Principle-based standards provide less detailed guidance on clear boundaries and use more professional judgment in the assessment of transaction substance and evaluation. To be able to have a professional judgment, the manager or accountant must have knowledge, skills, and ethics because if they do not have these three things will lead to inaccuracy in taking professional judgment. Managers still have the flexibility in the selection of accounting methods to manage the finances that can be done as long as it is still allowed in accounting standards. The selection of accounting methods will affect the company's earnings, among others, changes in the

procedure of imposition of depreciation expenses, inventory methods, and others. As a result of these changes will affect the increase or decrease in corporate earnings, the impact will undoubtedly lead to the extent to which the earnings persistence after the application of IFRS, especially in manufacturing companies. Subjectivity in implementing IFRS standards will precisely make financial statements difficult to [13].

### Managerial Implication

The results of this study indicate that the earnings information has information content for future earnings. Therefore, investors are advised to keep considering the use of information in the financial statements in decision making, although many factors can affect stock prices. According to the findings of the current study, IFRS enhances the value relevance, earning management and timely recognition of loss in organizations which has positive linkage with supply chain management. This phenomenon is an input for the regulator of Indonesia Financial Accounting Standards to make Indonesian supply chain companies must implement effective IFRS to boost up the supply chain management. .

## 4. Conclusions

This study has examined the influence of International Financial Reporting Standards (IFRS) on supply chain management in manufacturing companies of Indonesia as one of the attempts to resolve various issues of supply chain. results of the study have shown that IFRS had significant role in supply chain management. IFRS has maintained the key contribution to boost up supply chain management practices in Indonesian manufacturing firms. The company is maintaining earnings persistence the company's earnings to be valued both by investors and auditors for the sustainability of the company in the future. Earnings persistence is a measure of the quality of the earnings used by investors to assess firm performance.

However, this study does not measure the different levels of IFRS adoption by each company. The IFRS variables in this study were only measured dummy by IFRS year adopted in Indonesia. For future research could use other indicators to measure the IFRS adoption of a company-scale so that the value could vary for each company in one country, besides it can accurately describe how far

a company has adopted IFRS. Also, further research is expected to use other earnings persistence proxies that are also used in previous studies

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